No. 85-1080

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

October Term, 1985

SAN DIEGO GAS & ELECTRIC COMPANY,

Appellant,

v.

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA,

Appellee.

ON APPEAL FROM THE SUPREME COURT OF CALIFORNIA

SAN DIEGO GAS & ELECTRIC COMPANY'S REPLY TO MOTIONS TO DISMISS OR AFFIRM OF THE CALIFORNIA PUBLIC UTILITIES COMMISSION AND THE CITY OF SAN DIEGO

Stephen L. Baum
Jeffrey L. Guttero
*Barton M. Myerson
William L. Reed

*Counsel of Record for Appellant
San Diego Gas & Electric Company
101 Ash Street
San Diego, California 92101
(619) 235-7818

INTERIM PRINTING & MAILING COMPANY
1105 WEST MORENA BOULEVARD, SAN DIEGO, CALIFORNIA 92110 – 275-3050

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The City of San Diego (City) and the Public Utilities Commission of the State of California (Commission), respectively, filed a Motion to Dismiss or Affirm and a Motion to Dismiss (Motions) San Diego Gas & Electric Company's (SDG&E's) appeal herein. SDG&E files this response to those motions pursuant to Supreme Court Rule 16.5.

Overview

The constitutional deficiencies of the Commission's decisions, as raised by SDG&E in its Jurisdictional Statement, are confirmed by the failure of the Commission or City to squarely address them. For example, the Commission and City repeatedly refer to the asserted failure of SDG&E to meet its burden of proof as justification for the Commission's findings. Yet the Commission itself never invokes this as a basis for its findings in either of its decisions. And neither the Commission nor the City explain how the Commission could approve two-and-one-half years of SDG&E's expenses under the Restated Agreement, which earlier Commission staff testimony specifically supported as favorable, without having passed on the reasonableness of the contract itself. Nor do they explain how the Commission can now disapprove of the Restated Agreement *from its inception,* contrary to its earlier decisions, without having engaged in an unlawful hindsight analysis.

Moreover, the City argues that the "HIRI option" SDG&E gave up in signing the Restated Agreement was either to maintain current Hawaiian Independent Refinery, Inc. (HIRI) volumes or to more than double them for the last four years of the contract to 28,800 barrels per day. But the City fails to note that SDG&E's exercise of this "...flexible option to call on HIRI to deliver increased volumes..." (Interim Opinion, Appendix p. A-16) would have obligated SDG&E to purchase more than twice the amount of additional oil it actually purchased under the Restated Agreement!

The primary goal of the Commission's and City's Motions is to

obscure and divert this Court's attention from appellant's straightforward and substantial constitutional propositions. This is most clearly demonstrated by their perfunctory and conclusory responses to SDG&E's central theme in this appeal: That until the Commission takes evidence on and determines that course of action which SDG&E should have taken in 1979, the actual results of which can be compared to SDG&E's results under the Restated Agreement, the Commission shall be constitutionally constrained from determining the amount of expenses which should be disallowed. The Commission's adoption of an expense disallowance which has no causal nexus with SDG&E's actions is arbitrary and unconstitutional. *See Perkins v. Elg.*, 307 U.S. 325, 349-350 (1939). As SDG&E shall discuss in more detail below, the Commission's stance on this issue cries out for this Court's correction.

ARGUMENT

I.

NEITHER THE COMMISSION NOR CITY OFFER SUBSTANTIAL CHALLENGE TO SDG&E'S ASSERTION IT WAS DENIED DUE PROCESS BY THE COMMISSION'S FAILURE TO FIND ANY ALTERNATIVE ACTION WOULD HAVE AVOIDED THE DISALLOWED EXPENSES.

A. The Necessity For Determining A Standard Of Conduct.

The Commission argued to the California Supreme Court, and again asserts here that SDG&E has cited no authority for the proposition that the Commission had a duty to determine what SDG&E's reasonable course of action would have been before it calculates the "excessive" costs to be disallowed for ratemaking purposes. It disputes that civil tort case authority, requiring a causative nexus between the wrongdoing and the damage assessment, has any relevance to the Commission's action or regulatory law in general.

The proposition SDG&E advances here is so fundamental to damage assessment, and general logic, that it is incumbent upon the Commission to provide legal authority why appellant's position should be rejected, not vice versa. The Commission and its staff have consistently stressed that the $45 million disallowance assessment is neither a penalty nor a fine. The Commission's decision's challenged here make it abundantly clear that this disallowance is intended to constitute ratepayer *damages,* imposed to make them whole for SDG&E's imprudence. (Appendix, p. A-22.) This Court must judge the adequacy of the Commission's order on the same basis articulated by the Commission itself. *Securities & Exchange Commission v. Chenery Corp.,*318 U.S. 80 (1943). With that rationale at the heart of the order, how could civil damage case authority, representing literally hundreds of years of legal thought on this subject, be irrevelant? Yet the Commission's Motion shows disrespect for this fundamental legal precept of causation.

In truth, the Commission harbors not mere disrespect, but actual contempt, for the requirement of a causal relationship between utility imprudence and ratemaking disallowances or penalties. In recent decisions for SDG&E and Pacific Gas and Electic Company (PGandE), the Commission has imposed substantial disallowances/ penalties for certain ECAC expenses which the utilities were otherwise entitled to recover *without even a finding of unreasonableness.* (Decision Nos. 84-12-033; 85-12-104.)

The PGandE decision is particularly relevant. PGandE there sought cost recovery in an Energy Cost Adjustment Clause (ECAC) proceeding of amounts it expended to settle a lawsuit with Chevron U.S.A., Inc. (Chevron) over PGandE's termination of fuel oil deliveries under a long-term contract. Except for PGandE's terminating first and settling on payment later, its payment to Chevron was very analogous to SDG&E's $45 million payment to Tesoro under the Suspension Agreement to terminate the Restated Agreement. At the time of PGandE's payment, the Commission had in place a cost recovery mechanism (Annual Energy Rate, or AER) whereby

PGandE's shareholders were required to bear 9% of any unforecasted fuel related expenses. This mechanism was designed to provide PGandE with an incentive to economically manage its fuel costs, and actually gave it the opportunity to keep 9% of any fuel-related savings if its expenses were below forecasted levels.

But the 9% penalty which the Commission imposed without a finding of imprudence was *not* the 9% which PGandE already expected to absorb under the AER. This was an *additional* 9%, on top of the AER, of which PGandE had no notice when it negotiated its settlement, and which it could have avoided only by avoiding settlement, in contrast to the AER mechanism.

Similarly, the Commission's Decision 85-12-104 (of which SDG&E is currently seeking rehearing) disallows 8% of certain fuel oil disposal costs incurred by SDG&E, even though the Commission found SDG&E's actions were reasonable. (Decision 85-12-104, p. 6.)

The Commission called these disallowances "risk sharing," but they really are arbitrary state action, taken in the absence of evidence of imprudence and in open disregard of constitutional requirements. The Commission's disallowance of SDG&E's Tesoro contract expenses was no less arbitrary than its disallowance of PGandE's contract settlement expenses, or SDG&E's fuel disposal expenses, for it had no more evidence to support one than the others. If any vigor remains in the precept stated by this Court in *West Ohio Gas Co. v. Public Utilities Commission of Ohio (No. 1),* 294 U.S. 63, 72 (1935), that utilities are entitled to recover their reasonably incurred expenses, then it is essential that this Court reassert that the rules of ratemaking still require adherence to the United States Constitution. *Giaccio v. Pennsylvania,* 382 U.S. 399, 402-404 (1966).

B. SDG&E's Excluded Testimony Would Provide Evidence Of The Proper Standard

In this case that reassertion will include instructions that the

Commission admit the evidence of SDG&E's proffered witnesses who were prepared to testify to the consequences of the Restated Agreement. They were prepared to testify in the penalty phase hearings that there were no adverse consequences from the Restated Agreement because, even granting all of the Interim Opinion's criticisms of SDG&E, prudent management by SDG&E would not have resulted in SDG&E's ratepayers bearing a lower level of expenses. The Commission excluded the testimony, however, asserting that SDG&E was only attempting to "reargue" the reasonableness of the Restated Agreement, which the Commission had decided against SDG&E in the Interim Opinion. The Commission's decision never goes beyond this simple rationale for rejection, though, to analyze the alleged deficiencies of the testimony. While this constitutes an easy basis upon which to reject testimony the Commission did not want to hear, it is intellectually blind to the reasons for which SDG&E offered it, which was to provide evidence of the prudent course of conduct against which the Restated Agreement could be compared in order to ascertain its "actual consequences."

In fact, the Commission rejected this testimony only because of the ultimate conclusions the witnesses reached, not because the testimony attempted to justify the Restated Agreement—which it did not. The purpose expressly recognized in the prepared testimony of each of these witnesses was to consider, from the perspective of facts and circumstances as each understood them to exist in 1978 and 1979, what fuel strategy a utility situated like SDG&E should have followed at that time. Each discussed those facts and circumstances in some detail, including factors specific to SDG&E, and the various options in fuel strategies that were available to SDG&E. Each independently concluded that SDG&E should have sought to reduce its short-term powerplant oil supplies to take advantage of what was then considered to be the short-term availability of cheaper natural gas, but also should have attempted to line up reliable future oil supplies for the period when powerplant gas was not expected to be available. In general, each believed that the Tesoro Restated Agreement tended to conform to his recommended strategy.

But if these witnesses had reached some other conclusions, suggesting that a lower cost strategy than the Restated Agreement should have been pursued by SDG&E in 1979, SDG&E is certain the Commission would have embraced this testimony. There can be no misunderstanding on this point: The Commission rejected the testimony of SDG&E's consultants only because of its conclusions, not because of anything objectionable about its methodology or true purpose.

The Commission and City state SDG&E should have presented this testimony in the first hearing phase when the prudence of the Restated Agreement was at issue. SDG&E agrees this testimony would have been relevant there. But that fact did not make it irrelevant in the subsequent penalty phase hearings. For despite all the various assertions of the parties about the sufficiency of the evidence to support the Commission's findings and conclusions in its Interim Opinion, the Commission never made the one and only finding that could have justified its adopted expense disallowance, or any disallowance. Without a finding based on evidence of what the prudent course of conduct for SDG&E should have been, its findings could support neither its conclusion of imprudence nor any calculation of economic consequences.

Thus, SDG&E presented its outside consultant's testimony in the penalty hearing phase to provide an evidentiary basis on which the Commission could determine and measure the economic consequences of the Restated Agreement. That was precisely what the Commission ordered the parties to do in the Interim Opinion. (Appendix, p. A-22.) The Commission did not say, and could not have said, that such testimony would be objectionable if it failed to find actual adverse consequences. That SDG&E's excluded evidence showed no disallowance was appropriate was neither precluded by the Interim Opinion's findings nor rendered irrelevent thereby. The Interim Opinion's findings confined themselves to procedural and motivational wrongdoing that said nothing about ratepayer damages.

Accordingly, this Court should accept SDG&E's appeal to reverse the Commission's disallowance imposition and order the Commission to hear SDG&E's excluded evidence, thereby according SDG&E the due process to which it is entitled, but has heretofore been denied.

II.

THE EQUITABLE ESTOPPEL ARGUMENT WAS ADEQUATELY RAISED BELOW

The contention that SDG&E failed to raise an equitable estoppel argument in its earlier appeals is without merit. SDG&E's Jurisdictional Statement, at page 24, introduces the equitable estoppel argument under the heading:

> THE COMMISSION'S $45 MILLION DISALLOWANCE IS FUNDAMENTALLY UNFAIR IN LIGHT OF ITS PRIOR APPROVAL OF THE RESTATED AGREEMENT AND ITS FAILURE TO PROVIDE SDG&E ANY OPPORTUNITY TO MITIGATE ITS COSTS THEREUNDER.

SDG&E's previous filings have, in every instance, cited the factual and legal underpinnings of the equitable estoppel argument as it appears in the Jurisdictional Statement. If a litigant has brought a federal claim and the grounds therefore to the state court's attention with fair precision, and "...the record as a whole shows either expressly or by clear intendment that this was done, the claim is to be regarded as having been adequately presented." *New York ex. rel. Bryant v. Zimmerman,* 278 U.S. 63, 67 (1928); *Braniff Airways Inc. v. Nebraska State Board,* 347 U.S. 590, 598-599 (1954).

In SDG&E's Application for Rehearing of Decision 84-02-005 before the California Public Utilities Commission, the materials presenting the grounds for equitable estoppel are contained in pages 13 through 18 of the Application, and the argument is succinctly stated on page 19. In SDG&E's Petition for Writ of Review with California Supreme Court, filed on May 21, 1985, the factual and

legal bases for equitable estoppel are found at pages 15 through 18. In addition, SDG&E's Reply to Answers to the Petition for Writ of Review, which was filed with the California Supreme Court on July 19, 1985, contains the basis of the equitable estoppel argument on page 11.

As SDG&E's Jurisdictional Statement points out, the equitable estoppel argument is rooted in the concepts of fundamental fairness and due process. These grounds for review, as well as the factual basis for the equitable estoppel argument, have been repeatedly cited throughout SDG&E's appeals.

CONCLUSION

Neither the Commission nor the City have raised any dispositive objections to SDG&E's appeal herein, but have at best reaffirmed their inability to overcome the substantial constitutional infirmities of the Commission's decisions in question here. The Court should overrule their Motions for Dismissal and/or Affirmance.

Respectfully submitted,

Barton M. Myerson
Counsel of Record for Appellant
Stephen L. Baum
Jeffrey L. Guttero
William L. Reed
SAN DIEGO GAS & ELECTRIC CO.
Post Office Box 1831
San Diego, California 92112
(619) 235-7818

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